Munny Journey™
Keepsake Journal for Baby's First Money
PO Box 3394 Coeur d'Alene, ID 83816
208.660.3324 tel • 208.664.2588 fax • www.munnyjourney.com

First Financial Step for Kids May not be a 529 Plan

By Munny Journey Author Brad Dugdale

With high school graduation season in full swing, many parents are facing the prospect of paying college tuition in just a few months. As a college education continues to become more expensive, parents with even the youngest children are thinking about saving for the future.

Inquiries about saving for college become more frequent during the summer, particularly from grandparents who have recently welcomed a newborn into the family. Most want information on 529 Plans, a type of account designed to save for education that has enjoyed increasing popularity over the past several years. While a 529 Plan does have benefits for a college bound student, it may not be the first financial step to take for a child.

The main reason parents or grandparents may want to avoid a 529 Plan for a young child is because the use of the funds is restrictive. The money has to be used for qualified education expenses or else funds distributed from the account are subject to a 10% penalty and earnings are taxed as income. Parents and grandparents may have immediate visions of their newborn graduating from college, but in reality they may be better off waiting until there is interest on the child's part to establish the account.

This is not to say you shouldn't begin saving early. A saving and investing program starting at birth can put a child on the path to financial security, thanks to time and the miracle of compound interest.

If a parent or grandparent starts saving $1 a day for a child at birth, and that child continues to do that over their lifetime, that investment could grow to over a million dollars by age 65. This scenario assumes an average annual rate of return of 9%, which is similar to the return of the S&P 500 over periods of time of 20 years or more. Under that scenario, waiting just nine years to start saving would cut that return in half at age 65.

Parents or grandparents can open a custodial account for a child and make investments on their behalf. For those wanting to participate in the stock market, look for mutual funds with low expenses, low minimum investments and the ability to make ongoing contributions.

A custodial account does not offer some of the tax benefits associated with a 529 Plan, but it does offer more flexibility as a child grows and a chance to get involved in the investing process. As children get older, involve them in the decisions about how the funds should be used. If a child decides she wants to go to college, the money could be redirected into a 529 Plan. If she decides she'd rather save for retirement, it could go into an IRA once she begins earning income.

The most important first financial step is to just get started. This will give you more options in the future no matter what type of account the savings are in.

Brad Dugdale is a financial consultant with D.A. Davidson & Co. and author of the gift book, "Munny Journey: A Keepsake Journal for Baby's First Money" which illustrates the power of compound interest starting at birth. More information can be found at: http://www.munnyjourney.com